

THE COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

The Berkshire Gas Company

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D.T.E. 01-56

REPLY BRIEF OF THE ATTORNEY GENERAL

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REPLY BRIEF OF THE ATTORNEY GENERAL

I. INTRODUCTION

Pursuant to the procedural schedule issued by the Hearing Officer, the Attorney General files this Reply Brief for the purpose of responding to arguments made in the Initial Brief submitted by the Berkshire Gas Company (“Berkshire” or “Company”) in this proceeding on November 21, 2001. This brief is not intended to respond to every argument made or position taken by the Company. Rather, it is intended to respond only to the extent necessary to assist the Department of Telecommunications and Energy (“Department”) in its deliberations, i.e., to provide further information, to correct misstatements or misinterpretations, or to provide omitted context. Therefore, silence by the Attorney General in regard to any particular argument, assertions of fact, or statement of position in the Company’s brief should not be interpreted, construed, or treated as assent, acquiescence or agreement with such argument, assertion or position.¹

¹ The Company’s Initial Brief failed to respond to certain arguments made by the Attorney General in his Initial Brief dated November 14, 2001, and did not issue a disclaimer reserving those issues for determination by the Department. As a consequence, the Attorney General assumes the Company

Berkshire, the gas utility with some of the highest priced distribution rates in Massachusetts, seeks a rate increase of 9 % or approximately \$4.6 million dollars above current levels. The Company seeks this increase to offset the \$66 million dollars in costs and acquisition premium associated with the acquisition of Berkshire's parent company, Berkshire Energy Resources ("BER"), by an out-of-state holding company, the Energy East Corporation ("Energy East"). Berkshire has not demonstrated with substantial evidence that this merger with a holding company that owns non-contiguous assets in Connecticut, New York and Maine will generate consumer savings in Massachusetts. Instead, the Company proposes to increase overall rates by 9 % and then return to customers a fraction of their own money in the form of a 1 % "consumer dividend" as part of a Price Cap Mechanism ("PCM") that begins to operate only after a 31-month freeze of the increased rates. Unlike other merger-related rate plans approved by the Department, the Company's proposal involves neither a rate freeze at current levels nor a rate reduction.

II. OVERVIEW

A. THE COMPANY'S PROPOSAL DOES NOT COMPORT WITH OTHER MERGER PLANS APPROVED BY THE DEPARTMENT

The Company argues that it has no inefficiencies since it has not petitioned the Department for a base rate increase in nine years and it has lowered some costs. Co. In. Br., pp. 10-11. Although the Company did show some improvement as a result of lowering certain costs since its last base rate case, the decrease occurred from costs that were relatively some of the highest in the Commonwealth. The

has conceded these points and waived any further arguments in the Company's Reply Brief.

Company was and remains one of the most costly providers of gas transportation in Massachusetts. To say there were inefficiencies at Berkshire is an understatement and the record evidence in this case establishes that the Company continues to be inefficient.

The Company attempts at great length to reassure the Department of the benefits of the Plan for customers and the Plan's conformity with Department precedent. Co. In. Br., pp. 10-11, 16-17.

Nothing could be further from the actual impact of the plan. The Company Plan burdens customers with increased rates and no compensating net benefit. Rather than following precedent with regard to mergers and acquisitions, the Company takes an extreme position, carefully selecting from all of the various merger and rate plans that have been before the Department those elements that favor the Company's shareholders, resulting in the worst scenario for its customers. The only guarantee for customers is that they will have the highest gas transportation rates in the Commonwealth.

The Company's proposed treatment of the Energy East merger raises a number of concerns, as argued by the Attorney General in his Initial Brief, pp. 8-16:

! All of the other utilities in the Commonwealth who have sought rate plans as the result of mergers have proposed and had approved base rate freezes. Not Berkshire. It seeks an immediate increase now and seven subsequent increases all in a ten-year time frame.

! All of the other utilities have sought and had approved the nature and the amount of the recovery of merger-related costs.² Not Berkshire. It seeks blind approval from the

² The Company engaged in an effort to confuse the record regarding whether it is or it is not seeking recovery of merger related costs. The Company stated that it wants the "opportunity" to recover these merger costs by setting its revenue requirement to determine rates on a standalone basis. However, it claims that the Department does not have to approve the reasonableness of those acquisition costs since it is not seeking to specifically include them in rates. Yet, even under the Company's own scenarios, it will include some level of its acquisition related costs in future base rate setting proceedings after the end of its proposed rate plan or in those instances when the Department might seek to modify the plan after

Department to recover merger costs, for whatever reason and in whatever amount they are incurred.³

! All of the other utilities which have sought price cap plans have provided productivity studies showing not only a complete history of the productivity trends available, but also a showing that the company in question was comparable in terms of productivity relative to that industry group. Not Berkshire. It simply adopts the productivity levels of other gas distribution companies even though it knows that it is one of the least productive gas distribution companies in the state.

! The other gas distribution utility with a price cap plan is required to have an earnings sharing provision that ensures some maintenance of just and reasonable rates. Not Berkshire. It believes that an inefficient, high rate utility earning 25 percent return on common equity as a result of a price cap plan would still provide for just and reasonable rates.⁴

! Embedded in the Company's arguments regarding its Rate Plan is the confusion that it creates by mixing merger related savings with those savings result from a move away from the inefficiencies associated with cost of service / rate of return regulation to incentive regulation under the Price Cap Plan. All of the other utilities in the state have recognized and, more importantly, measured these as two separate and distinct savings concepts. Not Berkshire. By combining the "standalone" cost of service (with no recognition of expected merger savings) and the Price Cap formula increases, the Company is providing customers with the potential to capture one, but not both, of these savings as has been required in all of the other cases before the Department.

The Department should not seriously consider the Company's claim that increasing its admittedly

the mid plan review.

³ In the other merger and acquisition cases with rate plans, the Department specifically recognized the expected savings would exceed costs. The merger or acquisition provided benefits to customers. Furthermore, the Department specifically recognized the reasonableness of the transactions costs, including the price paid for the company by comparing the relative stock price paid for similar contemporaneous mergers and acquisitions. Berkshire made no showing in this case of the reasonable of either the price paid or the transaction costs incurred.

⁴ It should be noted that under a Price Cap Plan with an earnings sharing provision, the "pricing flexibility" that the Company seeks would contrary to the testimonies of Mr. Gordon and Ms. Zink, directly harm customers. The "price flexibility" would reduce the chances of sharing in any over-earnings, or conversely increase the chances of sharing in any earnings deficiency.

inefficient rates will somehow benefit customers.⁵ This one-sided, inequitable proposal is neither consistent with Department precedent regarding rate plans and mergers and acquisitions nor does it satisfy the requirements of creating just and reasonable rates. Therefore, for all of the reasons stated here and in the Attorney General's Brief, the Department should reject the Company's proposed rate plan en toto.

The Department has precedent regarding rate plans that provide for an opportunity for the recovery of merger like costs. *Essex Gas Company*, D.T.E. 98-27, pp. 65-71(1998) (company bears risk under rate plan for recovery of acquisition costs during a ten-year rate freeze). In *Essex Gas Company*, Eastern Enterprises Corporation, a much larger holding company, acquired a much smaller company. There, the Department considered the recovery of \$62 million of merger related costs in the context of a utility that had annual revenues of \$51 million.⁶ Tr. 8, pp. 947-949. The Department ordered a ten-year base rate freeze with the requirement that all merger related costs be recovered during that period. There was no rate increase. There was no open-ended, unspecified recovery period for merger costs.

The facts are the same in this case. Berkshire was acquired by Energy East, a much larger

⁵ The Company states that Attorney General "egregiously mischaracterizes" Mr. Allesio's testimony that the proposed cast off rates would result in a revenue requirement that is higher than its actual cost of providing service. Co. Br., p. 53. The Company based this argument on the rather novel proposition that merger costs are actually required to provide regulated gas distribution service to customers. *Id.* Of course, this notion is not true in either economics or regulatory price setting.

⁶ It should be noted that in *Essex*, there were no actual acquisition costs since the companies merged, without the creation of any acquisition premium. The Department was forced to create an acquisition premium fiction in order to make the regulatory asset. Similarly, here the Department will have to create a regulatory asset fiction since the Company has not sought approval of nor has it proven the reasonableness of its acquisition premium.

holding company. The claimed costs of the acquisition are \$67.2 million and the Company's annual revenues are \$54.8 million.

The Department, if it considers allowing any rate plan for Berkshire that provides for the recovery of acquisition related costs, should follow its precedent in Essex.⁷ Since the facts are the same and the underlying incentives of the Department's mergers and acquisitions still apply, the Department should follow its own precedent in Essex. The Company has provided no reason for the Department to depart from its order in Essex. Nor has the Company provided any reason why its customers should be put in a more unfavorable position than the customers of Essex. Reasoned consistency is required in the Department's findings. *Boston Gas Co. v Department of Public Utilities*, 367 Mass. 92, 104 (1975). Therefore, the Department, if it allows the Company to recover any acquisition related costs, should order the Company to freeze base rates for ten years so that it can have the opportunity to recover all of those costs during that period.

B. THE COMPANY HAS OFFERED NO CASE LAW, PRECEDENT OR ARGUMENT WHICH WOULD AFFORD SPECIAL CONSTITUTIONAL STATUS TO MERGER COSTS AND ACQUISITION PREMIA

Berkshire states that it will forgo pushing down merger costs from the holding company into the base rates of the distribution company in exchange for an opportunity to reap the rewards of merger enabled savings. Co. In. Br., pp. 9-10, 11, 15 n. 10, 31-32, 41- 42. Berkshire implies that it possess an immutable property right to the recovery of an acquisition premium and merger costs by stating that

⁷ The Attorney General only offers this as the alternative if the Department allows the Company to recover acquisition costs in some future case. In this case the Department cannot find those costs to be reasonable in nature or amount since the Company has offered to proof as to either.

it will forgo a push down of costs. *Id.* at pp.31-32. These merger related costs, however, do not represent funds expended for the delivery of gas distribution service. The Constitution does not guarantee the inclusion of an acquisition premium in rate base, as the Company suggests. *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 601-607 (1944) (upholding the rejection of the use of “fair value” rule and any investor right to appreciation in the value of utility property). Berkshire’s proposal is reminiscent of the long abandoned fair value method of valuation announced in *Smyth v Ames*, 169 U.S. 466 (1898) with its “laborious and baffling task of finding the present value of the utility.” *Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission*, 262 U.S. 276, 292-294 (1923) (Brandeis dissent); *Permian Basin Area Rate Cases*, 390 U.S. 747, 769 (1968) (interests of both customers and investors are variables in the ‘constitutional calculus’ of rate determination).⁸ Rates must be based upon objective criteria, as implicitly acknowledged by the Department’s traditional use of the historic test year approach. *See Fitchburg Gas and Electric Light Co.*, D.T.E. 99-118 (2001); *See also Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. at 601-607 (1944) (approving historic cost approach).

The Company’s rate plan is inconsistent with Department precedent and raises serious issues as to the just and reasonable nature of the resulting rates. Under the guise of the “no net harm” standard Berkshire seeks the advantage of setting a rate increase with a “stand alone” calculation on the

⁸ Capital assets should not “be valued by the stream of income they produce because setting of that stream of income was the very object of the rate proceeding.” *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 309 n. 5 (1989). “The heart of the matter is that rates cannot be made to depend upon ‘fair value’ when the value of the going enterprise depends upon earnings under whatever rates may be anticipated.” *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. at 601.

unsubstantiated promise of future merger related savings.⁹ Should these future savings not result or should the Department modify the filed rate plan in its final order, then the Company desires the opportunity to petition the Department for additional merger related cost recovery from customers. Co. In. Br., pp. 9-10, 11, 15 n. 10, 31-32, 41- 42. The Company proposes to return to customers as a merger savings a tiny fraction of the 9 % general rate increase in the form of a 1 % consumer dividend under the PCM. Co. In. Br., pp. 8, 20, 45-46 (testimony of Dr. Kenneth Gordon). This merger savings feature is simply part of the Company's overall and roundabout attempt to value the acquisition premium through the Department's rate setting process.¹⁰

The Department's standard of review in merger cases should not be so simple as to guarantee recovery of acquisition costs and premiums. The Department precedent repeatedly speaks of demonstrable savings as one of the many factors to be considered in the evaluation of merger cost recovery. *Mergers and Acquisitions*, D.P.U. 93-167-A, pp. 6, 7, 9 (1994). As applied to any specific merger, these savings must be real, rather than illusory, in order for the standard of review to be meaningful in a constitutional sense. Since the stand alone calculation accrues benefits only to the

⁹ The Attorney General has appealed the merger decisions in *BEC Energy / ComEnergy*, D.T.E. 99-19 and *Eastern Enterprises-Colonial Gas Company*, D.T.E. 98-128 (1999) and frames his arguments, as he must, in this case with the understanding that those Department's orders are in effect until modified or overturned by the Massachusetts Supreme Judicial Court. As the appeals are still pending, nothing in this brief should be construed as an adverse admission or waiver of any legal or factual argument that the Attorney General may make in the pending appeals.

¹⁰ The Company makes this 1 % figure act as both the merger savings element and the "consumer dividend" element of the PCM even though consumer dividends are a separate and distinct variable in a PCM. *Boston Gas Company*, D.P.U. 96-50-C (Phase I) p. 56 (1996) (the consumer dividend signifies the expected future gains in productivity for companies that make up an industry due to the move from cost of service regulation to PBR).

Company to the extent that merger savings exceed merger costs, then the resulting rates to customers can not be said to be just and reasonable.

Commissions historically rejected the inclusion of acquisition adjustments into rate base because the amount of capital invested in utility plant does not change with the merger. *Federal Power Commission v. Gas Pipeline Co.*, 315 U.S. 575, 593 (1942). Inclusion of acquisition adjustments could inflate the return on the original cost rate base to speculative, and therefore, unconstitutional levels. Speculative rates of return are prohibited. *Bluefield WW & Improvement Co. v. Public Service Commission*, 262 U.S. 679, 692-693 (1923). It is the duty of the Department to protect “consumers from exorbitant rates.” *Washington Gas Light Co. v Baker*, 188 F.2d 11, 15 (1950). In this case, Berkshire’s requested rate increase under a “stand alone” calculation and the opportunity to seek recovery of acquisition adjustments result in rates that are neither just nor reasonable.¹¹ The Company’s proposal simply churns the assets of “public utility property for the purposes of driving up rates” and must be rejected by the Department. *Railroad Commission v. Houston Natural Gas Co.*, 289 S.W.2d 559, 570 (1956) citing *Niagara Falls Power Co. v Federal Power Commission*, 137 2d 787 (1943) (Learned Hand). Therefore, the Department should reject the Company’s plan and allow merger related cost recovery, if any, only on the conditions and to the extent afforded the utility in *Essex. Essex Gas Company*, D.T.E. 98-27, pp. 65-71.

III. THE RATE PLAN

¹¹ The Attorney General would not oppose recovery of merger related costs so long as quantifiable net present benefits to consumers are demonstrated as a result of the merger. Placing an acquisition premium into rate base, however, is an improper method for cost recovery given the inherent subjective nature of the relationship between the calculation of future rates and the acquisition premium.

A. SERVICE QUALITY

The Company obstinately continues to claim compliance regarding the Department's long standing requirement that all companies filing for rate increases must file a PBR rate plan that includes a service quality component.¹² *Co. In. Br.*, pp. 35-36. *Boston Gas Company*, D.P.U. 96-50 (Phase I), pp. 309-310 (1996), *Fitchburg Gas & Electric Light Company*, D.T.E. 98-51, pp. 6-7 (1998) and *Service Quality Standards*, D.T.E. 99-84, pp. 40-42. The Company has an obligation to provide a well designed service quality plan that satisfies the requirement of D.T.E. 99-84. Customers' service quality interests must be considered and addressed, not only as part of the ratemaking freedom permitted under PBR regulation, but also as part of the changes that may be inflicted on them as a result of the merger with Energy East. PBR regulation and mergers put customers at risk for diminished service since companies may cut service to increase shareholder wealth. *Incentive Regulation*, D.P.U. 94-158, p. 54 (1995). For Berkshire to deny their customers any meaningful service quality standard is simply not in the public interest. The Company generated an SQI plan only in response to dogged discovery by the DOER months after the filing of the rate case.¹³ That plan is seriously lacking. In spite of knowing since at least 1996 when the Boston Gas plan was instituted that call

¹² The Company filed its rate case on July 17, 2001 and incorporated only statements that it intended to comply with whatever the Department ordered regarding service quality. Exh. BG-1, p. 22 and BG-22, p. 15. The Company filed no plan or benchmark performance statistics. Exh. BG-1, p. 22 and BG-22, p. 15.

¹³ The Attorney General supports the considerable efforts of the DOER in pursuing the details of the Company's plan. Although the Department has established generic standards, it is impossible to consider compliance without an individual company plan to review. DOER Brief, pp. 8-20. Not providing such a plan undermines the Department's policy. Given the already overburden discovery schedule in this case occasioned by the Company's complex filing, divulging the SQI plan only during hearings impaired the rights of the parties to examine the matter.

center response time, service appointments met and on-cycle meter reads would continue to be a key elements of service quality plans, the Company now claims it does not have sufficient data to implement these three standards. Co. In. Br., p. 36 and Exh. DOER-3-1. Berkshire appears to have made an economic decision not to put in place systems that would allow it to develop meaningful service quality measures.¹⁴ The Company should pay the maximum penalty attributable to these three categories until such time it can comply with the Department's mandate.¹⁵

B. PRICE CAP FORMULA

1. INTRODUCTION

The Company proposes as part of its Rate Plan to implement a Price Cap formula that will subject rates to annual increases. The Attorney General argued on brief that the Department should reject the Company's proposed Price Cap formula because Berkshire has provided essentially no evidence to support its proposed productivity factor and has proposed an expansive definition of allowable exogenous costs contrary to Department precedent.

¹⁴ The Company seeks to recover through its rates more than \$200,000 in telephone system upgrades. DOER-1-4 (supplement), pp. 2-3. There is no support for this cost of service adjustment on the record absent the material supplied in response to DOER discovery requests. This material raises more questions than it answers: 1) was this a prudent investment made solely for the benefit of the utility customers; 2) should this type of investment been made as part of the Company's Y2K efforts; and, 3) what was done to make the Company's existing systems Y2K compliant? Without the opportunity to examine these issues to determine the prudence of the investment the Department should not approve the recovery of any phone related costs either as part of cast off rates or as a potential exogenous cost.

¹⁵ The delay in implementation of these three standards is troubling. The base line established will not include any meaningful data from the period prior to the Company's merger with Energy East. The Company will be free to enhance merger related profits at the cost of their customers' service quality.

2. THE COMPANY HAS NOT PROVIDED ANY SUPPORT FOR ITS PROPOSED PRODUCTIVITY FACTOR

The Company proposes to include in its Price Cap formula a productivity factor or X-Factor of one percent based on the studies presented in the Boston Gas Company Price Cap case. *Boston Gas Company*, D.P.U. 96-50 (1996); Exh. BG-22, pp. 12-13. The Attorney General argued that the Company did not provide the Department with substantial evidence to support the proposed productivity factor, and, in fact, the evidence indicates that the productivity factor for Berkshire should be much higher than the factor the Department set for the Boston Gas Company. Specifically, the Company failed to: (1) perform any quantitative analysis regarding its productivity; (2) show that its productivity is comparable to that of Boston Gas Company or the gas distribution companies in the North East United States; and (3) update the study for the most recent information available.

The Company, on brief, relies on Mr. Gordon's testimony regarding the productivity factor for its proposed one percent consumer dividend. Its arguments for the one percent dividend include: (1) the Company has no accumulated inefficiencies and therefore, the Department should not provide any in its determination of the Price Cap formula; (2) the cost of a productivity study is unreasonably high; and (3) Berkshire is essentially the same as Boston Gas Company, and therefore, it should have the same productivity factor. As will be discussed below each of these arguments is simply wrong.

The Company highlights the testimony of Mr. Gordon in this case as evidence of the reasonableness of its proposed productivity factor. In fact Mr. Gordon could provide no such evidence, other than some broad brush statements regarding the productivity factor for gas distribution companies that were completely unsupported on the record in this case. Mr. Gordon could provide no

evidence of the reasonableness of the proposed productivity factor for Berkshire Gas Company.

Although Mr. Gordon may be “highly qualified” to discuss some regulatory policies, it is clear that he is not qualified, nor did he even attempt to qualify himself, as an expert by doing one productivity study here or at any other time. The Department should summarily reject Mr. Gordon’s recommendations and the Company’s proposed productivity factor since there is no evidence to support either in this case.

The Company also argues that it has made some herculean efforts, refraining from filing a base rate in the past nine years, squeezing all inefficiencies out of the Company, and thus benefitting customers. Although these efforts may appear to be significant, the end result is the Company is still inefficient, with the highest transportation rates in the state. When a firm starts that far off of the average, it has that much more to make up. The Company still has a significant amount of inefficiencies to squeeze out of its business and results in its fear of providing any quantitative proof of its productivity relative to the industry.¹⁶ Thus, the Company’s claim to have a “second generation” rate plan is not only unsupported by the record, it is contradicted by it.

The Company continues to argue that the cost of a productivity study for the Company would have made it prohibitive for the Company to perform the analysis in this case. First, the Company’s productivity factor witness testified during cross-examination that the cost to update the study would be between \$50,000 and \$150,000 in this case. Then, when he realized that the cost of such a study

¹⁶ Mr. Gordon’s confusion in this case regarding the accumulated inefficiencies and the consumer dividend, where he essentially equates the two belies his testimony as to the “conservative” nature of his productivity factor recommendations, for in NYNEX he clearly defined their differences and quantified each separately at one percent for a total of two percent adjustment to the base productivity factor. *NYNEX, D.P.U. 94-50 (1995)* (Gordon, chairman).

might be an issue in this case, he inflated his estimate to an incredible amount of \$500,000. First, the witness' inflated estimate was based on nothing more than heresy. Second, it should be remembered that the cost of the original study done by two expert witnesses for Boston Gas Company was significantly below the \$500,000 level and an effort to update that study and include Berkshire would have cost less than the original study. The Department should ignore this obvious scare attempt by the Company to avoid its obligation to prove its case.

Finally, as was discussed in the Attorney General's brief, there is no evidence to support the Company's claims and Mr. Gordon's testimony that the Company is comparable to Boston Gas or for that matter to any other gas distribution company, in terms of its productivity. The Company's failure to have National Economic Research Associates ("NERA") perform a productivity study is understandable given NERA's recommendations for Energy East utilities in other jurisdictions. For instance in Central Maine Power Company's Seven Year Rate Plan, NERA proposed a 0.67 percent productivity in the first year of the plan that actually increased over 3 years to 1.42 percent for the last four year of the rate plan. Exh. AG-4, pp. 12-13, Table 1. Obviously, the Company's fear of providing a study is understandable and provides more evidence as to the necessity that one be performed for Berkshire. Thus, the Department must reject the Company's proposed productivity factor and the resulting price cap plan.

3. THE EXOGENOUS COSTS SHOULD CONFORM TO DEPARTMENT PRECEDENT

The Company's proposed Price Cap formula includes an adjustment to rates for exogenous

costs.¹⁷ The Attorney General argued that the Company's proposed exogenous cost definition greatly exceeds the definition of exogenous costs adopted by the Department in the other rate plans it has approved for other Massachusetts utilities and should reject the Company's expansive definition. In its place, the Attorney General argued that the Department should order exogenous costs to be consistent with the definition of exogenous costs included in the many rate plans that it has approved prior to this case. *NYNEX*, D.P.U. 94-50, pp. 172-172 (1995); *Boston Gas Company* D.P.U. 95-50 (Phase I) , p. 292 (1996); *Bay State Gas Company*, D.T.E. 98-31, p. 17 (1998); *Essex Gas Company*, D.T.E. 98-27, p. 19 (1998); *Colonial Gas Company*, D.T.E. 98-128 p. 55 (1999).

The Company argues on brief that Lost Base Revenues ("LBRs") should be included as exogenous costs citing *Bay State Gas Company*, D.T.E. 00-106 (Letter Order of March 30, 2001) and *Colonial Gas Company*, D.T.E. 00-73. However, in that case, the LBRs were an exogenous costs since they were the result of a change in accounting, legislative, or tax laws or regulations. Bay State's rate plan went into effect before the Department's change in policy regarding LBR's. *Id.* Similarly, the basis for the Department's decision allowing Colonial Gas Company to recover LBRs is that the change in regulatory policy took place after the rate plan went into effect. *Id.* Here, no such change in accounting, legislative, or tax laws or regulations exists. Therefore, the Department should deny the Company's request to include LBRs as an exogenous cost if it allows any rate plan.

4. THE COMPANY REQUESTS UNAUTHORIZED PCM PROTECTIONS

The Company seeks a variety of protections for the PCM that are inconsistent with the

¹⁷ The exogenous costs are generally defined as the costs that are outside the Company's control and that do not effect the economy in general. *Boston Gas Company* D.P.U. 95-50 (Phase I) , p. 292 (1996).

General Laws and Department precedent. Co. In. Br., pp 28-30. Berkshire seeks to raise the quantum of proof required during the PCM review to “clearly” or “clearly and substantially” from the “preponderance” standard imposed by statute. G. L. c. 30A, §1(6). The Company also seeks to eliminate the test year approach with pro forma adjustments for rate evaluation in favor of ten year average standard. Finally, the Company seeks to replace the just and reasonable standard for rate review with a “no harm” standard. The Company has offered no arguments which would support such protections, and the Department should reject them.

IV. REVENUE REQUIREMENT

A. REVENUES

1. THE DEPARTMENT SHOULD DENY THE COMPANY’S PROPOSAL TO ADJUST TEST YEAR REVENUES FOR ANTICIPATED CHANGES IN RATE DESIGN

The Company proposes to reduce test year revenues by \$54,344 for an anticipated change rate design.¹⁸ Exh. BG-6, Schedule JJK-22, Exh. BG-25, p.7. The Attorney General argued on brief that the Department should reject the Company proposal because these anticipated rate changes were simply rate design modifications, and, as such, should be reflected in the allocation of costs among rate classes and the billing determinants used to set rates.

The Company argues in favor of a revenue adjustment related to moving the Company’s quasi-firm customers from a demand rate to a volumetric rate, an adjustment unsupported by Department precedent. First, the Company justifies the adjustment by stating that “rates” are being

¹⁸ The proposed adjustment reflects the Company’s anticipation of moving these customers off of rates Q-42, Q-43, Q-52, and Q-53 which have been closed to other comparable rates. *Id.*

completely terminated. Co. In. Br., p. 75. The Company's proposal eliminates tariffs, but the customers are retained. They will continue to be served under new tariffs. There is no loss of customers or sales, simply a change in the rate structure under which these very same customers will be billed.¹⁹

Second, the Company mischaracterizes the Department's precedent by implying that the Department somehow permitted a revenue adjustment for lost revenues resulting from the simple reclassification of a customer from a demand rate to a volumetric rate. Co. In. Br., p. 76, *citing Fitchburg Gas and Electric Light Company*, D.T.E. 99-118 (2001). In *Fitchburg*, the Department permitted an adjustment to test year revenues for the loss of a customer that represented approximately 20 per cent of the Company's load. *Id.* at 14-20. The Department's adjustment was based on significantly changed usage levels. Here, this is no indication that usage levels will be any different in the future for these customers.

Company's Initial Brief does not provide any precedent for the rate design related revenue adjustment. The Company designs its rates to collect the revenue requirement by creating rates based on class specific bill determinants. The bill determinants for the quasi-firm customers have been reflected in the appropriate classes; therefore, the Company's rates are designed to recover the Company's full cost to serve. Exh. BG-16, Schedule PMN-6 and Rate Design Workpapers, p. 162, and Exh. BG-26, Schedules JMB-1 and JMB-5. The Department should deny the Company's

¹⁹ The adjustment as calculated by Ms. Boucher is based on test year usage levels and reflects the usage for approximately 25 quasi-firm customers. Exh. BG-26, Schedule JMB-5. The number of customers does not coincide with the Company's bill impact analyses provided in response to AG-RR-24, where only 15 customers were included for the same classes—a curious disparity.

proposed adjustment.

2. THE PROPOSED TEST YEAR REVENUES SHOULD REFLECT THE MORE ACCURATE MEASURE OF UNBILLED REVENUES THAN THE COMPANY DETERMINED

The Company proposes to reduce test year revenues by \$609,173 to remove its estimate of the unbilled revenues associated with service provided before the test year associated with a change in the methodology that it uses to account for unbilled revenues. Exh. BG-5, pp. 27-28 and Exh. BG-6, Schedule JJK-35. The Attorney General argued on brief that the Department should reject the Company's proposal to use its rough accounting estimate of the unbilled revenue instead use the more accurate measure that was provided in the evidentiary record in this case that better reflects the billing cycles that the Company actually incurred and that can be used to produce a revenue level more representative of actual test year revenues. Berkshire argues two points that appear to support the Attorney General's position: (1) an accounting accrual for financial reporting purposes should not necessarily be used for rate design purposes (citing DTE-RR-37 and Boston Edison Company, et. al. D.T.E. 99-19, p. 45; Massachusetts Electric Company, D.P.U. 92-78, pp. 80-81 (1992); and Bay State Gas Company, D.P.U. 89-81, p. 33 (1989); and (2) the unbilled revenue calculation has an inherent amount of estimation and variables such as weather, billing adjustments and timing. Co. Br., p. 77 (citing DTE-RR-37). This is exactly what the Department should do. It should ignore the financial accounting estimate of unbilled revenues to determine an estimate that better reflects the weather, and billing cycles as was provided in DTE-RR-37. Thus, the Department should make the Attorney General's recommended adjustment to determine a more representative level of test year revenues.

V. RATE BASE

A. WHATELY LNG PLANT ADDITION

1. WHATELY LNG PLANT RATE BASE ADDITION IS NOT SUPPORTED BY RECORD EVIDENCE

The Company proposes to include in its rate base a new LNG facility it had built in Whately, Massachusetts in its Greenfield Division (the “Whately facility”) and placed in service at the beginning of the test year. The Attorney General argued on brief that the Department must reject the Company’s proposed addition of the Whately LNG facilities since it not meet the Department’s used and useful standard. Specifically, the Company has not shown that it needs the increment of capacity provided by the Whately facility for reliability on the system or to meet the growth in demand during the rate year.

Although the Company claims that it presented “substantial evidence that the LNG plant additions were prudently incurred and used and useful,” there are scarcely any references to the need, benefits and costs associated with the new LNG facilities, let alone any quantification or analyses of the benefits of the facilities in the Company’s filing. *Co. In. Br.*, p. 61. The Department’s definition of used and useful dictates what Berkshire must demonstrate:

The regulatory standard which meets the Department’s goals of promoting efficient utility planning is the used and useful standard. “Used” under this standard requires that the given investment be in service and operating to provide benefits to customers. “Useful” under this standard requires not only that the investment be used, but also that it be needed and economically desirable in providing continuing service to customers.

Western Massachusetts Electric Company, D.P.U. 84-25, pp. 40-41 (1984). The Company acknowledges the Department’s ratemaking requirement that a rate base addition must be used and

useful and that the used and useful determination is made *at the time* “rate treatment is requested.” Co. In. Br., p. 64, citing *Western Massachusetts Electric Company*, D.P.U. 85-270 (1986).

The only references in the Company’s filing referred to were less than a single page of Mr. Allesio’s testimony (page 11),²⁰ and no more than a single page of Ms. Zink’s testimony (page 8 carrying over to two lines on page 9). The lack of documentary evidence and economic analysis required by the Department for approval of a significant rate base addition is troublesome, particularly given the Company’s claim that the LNG Plant addition is “one of the principal factors in terms of the Company’s need for rate relief.” Co. In. Br., p. 62.

After the rate case was well under way and then only in response to discovery did the Company provide any analysis supporting this rate base addition. Exh. AG-12-17 (selections from 1999 report and cost analyses filed in EFSB 99-2/DTE 99-17). This material is less than complete and its late filing (more than two weeks after the close of discovery) effectively denied the Department and other parties the opportunity to review the economic analysis and the underlying assumptions. To enter evidence on brief by reference to a docket not incorporated by reference during the hearings is inappropriate and should not be considered record evidence. All references to documents not filed in this docket should be ignored by the Department. The Department should exclude the Whately LNG Plant from rate base as the Company has failed to prove with substantial evidence that the addition qualifies under existing Department precedent regarding rate base additions.

2. THE COMPANY’S OLD LNG EQUIPMENT IS FOR SALE AND SHOULD BE REMOVED FROM RATE BASE

²⁰ The Company attempts to increase the weight of this evidence by expanding this citation to three pages (Exh. BG-1, pp. 10-12). Co. In. Br., p. 61.

The Company has included its old LNG equipment in plant in service used to determine rate base in this case. Exh. BG-14, Schedule of Indicated Remaining Life Accrual Rates, page 1. The Attorney General proved on brief that the plant was no longer used and useful and should be removed from rate base. AG Br., pp. 25-26. In response, the Company argues that the plant should remain in rates because it is always available for standby and could be “reactivated” at anytime like its inactive services. Co. In. Br., p. 68. citing Berkshire Gas Company, D.P.U. 92-210, pp. 25-26. The fact is, that by definition, if the plant is not active it is not used an useful. The Company has already determined that it is surplus since it seeks to sell it. And finally, the Company’s comparison to inactive services is inappropriate since (1) the inactive services are not redundant assets; and (2) the inactive services cannot be sold to other businesses.

3. THE COMPANY ALLOCATION OF PROPANE BUSINESS COSTS TO BERKSHIRE PROPANE, INC. DOES NOT CONFORM TO THE DEPARTMENT’S AFFILIATE TRANSACTION REGULATIONS

The Company proposes to allocate 95 percent of the costs of its propane utility plant in service to its affiliate Berkshire Propane, Inc. based on the historical embedded costs of the plant. *Id. citing* Exh. BG-15. The Attorney General argued on brief that Company failed to meet the Department’s regulations governing affiliate transactions that require a utility to charge the higher of book value and market value for all transactions with its affiliates. AG Br. pp. 26-27 *citing* 220 C.M.R. § 12.00 and D.T.E. 98-61/87, pp. 19-20 (1998). The Company argues on brief that (1) it is the Department that determines market value pursuant to 220 C.M.R. 12.04(1); and (2) since the tanks are old, they must have little market value. Co. Br., pp. 69-71. Both of these arguments miss the mark.

The Department's regulations require the Company to make all affiliate transactions at the higher of market or book. 220 C.M.R. § 12.04(1). It is the Company that must make a showing that it is not underpricing those services. While the Company criticizes the Attorney General's use of the market price of the Company's assets as a basis for valuing the propane assets, it provided no other proof in this case of their market value.²¹ Similarly, the reliance on the net book value of the propane plant is totally inappropriate since both the Energy East and the Berkshire Propane cannot not run that business without it. For all of the reasons here and in the Attorney General's Brief, the Department should determine the market value of the Company's propane tanks at 287 percent of their book value, and the excess above book value should be credited to the Company's utility cost of service in this case.

VI. WORKING CAPITAL LEAD / LAG FACTOR

A. THE COMPANY HAS OVERSTATED THE BILLING LAG IN ITS CASH WORKING CAPITAL ALLOWANCE

The Company prepared a lead / lag study to determine the lead / lag factor that it would use in determining its cash working capital requirement for base rates and for its Cost of Gas Adjustment Clause ("CGAC"). Exh. BG-25, pp. 3-4 and Exh. BG-26, Schedule JMB-4. The Attorney General argued that the Company's study in this case inflated its revenue lag by double counting the billing lag, since the automatic meter reading allows for instantaneous conversion of the raw meter data into the

²¹ Its interesting that the Company finds these valuations appropriate for valuing the gas distribution business acquisition premium but finds them useless for determining the propane business.

accounting system and the accounts receivable from which the Company has measured the customer payment lag and the Department should remove the Company's billing lag from its determination of the Company's net lead/lag days that it uses to determine the cash working capital allowance for both base rates and purchased gas expense. AG Br., pp. 28-29. The Company argues that the eliminating the "billing lag" days that the Company has included in its lead / lag study will somehow deprive it compensation for a legitimate delay in cash receipts. This is not true and that is not the Attorney General's position.

The Attorney General clearly indicated that the methodology that the Company uses to determine the payment lag, based on the accounts receivable, should already compensate the Company for billing lag since the account receivable should be recorded well before the bill is put in the mail. In fact, as the Company's witness indicated, since the accounting can take place essentially instantaneously with the downloading of the meter read information, the manner in which the payment lag is determined requires that all of the Company's "billing lag" be eliminated. When using the accounts receivable methodology, the Company double-counts the billing lag when it attempts to add on the time it takes to send the billing information to the vendor, have it printed, stuffed in envelopes and put in the mail. The Department must reject the Company's proposed "billing lag" addition since the Company is already compensated for those costs.

VII. COSTS OF SERVICE

A. WAGES AND SALARIES

1. THE COMPANY'S 2001 MANAGEMENT SALARY INCREASES ARE NOT

REASONABLE

The Company proposes to adjust its test year cost of service by \$ 29, 500 or 11.7 percent increase in officers and directors salaries for 2001. Exh. BG-6, Schedule JJK-8. The Attorney General argued that the Company's proposed adjustment should be denied by the Department since the Company provided neither testimony nor a study to support the magnitude of the increase, and argued in the alternative, the Department should limit any increase to the cost of service for the year 2001 officers' and directors' salaries to the 2.75 percent increase provided to union employees during that year. AG Br., p. 30 *citing Boston Gas Company*, D.P.U. 96-50 (Phase I), p. 42 (1996) *citing Fitchburg Gas & Electric Light Company*, D.P.U. 1270/1414, p. 14 (1983). The Company makes two arguments regarding the executive increases: (1) a correlation that puts executive salary increases at three times union increases meets the Department's correlation requirements; and (2) the 11.7 percent increase for executives is reasonable, since the Company, only after the Department made a specific record request for the information, provided a study (the "CFS Study") of the executive salaries.

The first argument regarding correlation, the Attorney General does believe that there has been a relationship between executive and union salaries, although rates of increase at three time the union rate does not really indicate a correlation. Second, regarding the Company's reliance on the CFS Study as a measure of reasonableness is inappropriate since the study is fundamentally flawed in two ways. First, the study used companies with annual revenues five times higher than those of Berkshire, obviously biasing the results and the executive compensation requirements upwards. Second, the study further assumed a split of the compensation requirements, 80 percent utility and 20 percent non-utility to determine the appropriate compensation level for Berkshire since it has non-utility operations.

However, this assumption again biases the survey's results upwards, since the Company's utility operations represent more than 92% of Berkshire Energy Resources operations based on the Company's own fair market value analysis, as flawed as it is: $92.4\% = \$66,263,858 / \$71,694,178$. Exh. AG-10-12, p. 1. Therefore, since the CFS study is fundamentally flawed and overstates the true market compensation for executives, it should be rejected by the Department as any evidence of reasonableness of the Company's salary levels and salary increase. Instead, the Department should allow a more reasonable 2.75 percent increase similar to that negotiated at arms length with the union employees in the Company.

2. THE DEPARTMENT SHOULD DENY THE COMPANY'S ATTEMPT TO INCLUDE AND ANNUALIZE THE SALARIES OF OFFICERS THAT ARE NOT EMPLOYED BY THE COMPANY

Berkshire proposes to include in its pro forma cost of service the former Chief Executive Officer Scott Robinson and former Vice President, Michael Marrone who no longer employed by Berkshire. Exh. BG-5, p. 11. The Attorney General argued on brief that the Department should reject the Company's proposal to include in its revenue requirement any costs associated with Mr. Robinson and Mr. Marrone, since these costs are not going to be, in fact, incurred in either the rate year or in the future. AG Br., pp. 31-34. The Company argues again that the loss of these employees is a savings that it should retain during the "standalone" rate plan period. Again, the Attorney General does not believe the Company has shown there is any basis for any such "standalone" treatment in this case, so for that reason alone the Department should reject the Company's proposed adjustment. See Rate Plan section, *supra*. However, assuming *arguendo* that the revenue requirement should be determined on a standalone basis, the Company has only shown in this case that it has saved cost by reducing

salaries through the early retirements of two highly paid employees. Those executives were quickly replaced by two other employees who saw their salaries increase substantially as a result. *See* Year 2001 Executive Salary Increase section, *supra*.²²

3. THE DEPARTMENT SHOULD REJECT THE COMPANY'S PROPOSED INCREASE IN HEALTH CARE COSTS

The Company proposes to increase its test year cost of service by \$182,245 for projected medical cost increases which represents a 19.8 percent increase over the test year medical expenses for the utility business. Exh. BG-6, Schedule 32. The Attorney General argued on brief that the Department should deny the Company's proposed adjustments to its test year medical expense since they are not known and measurable and overinflated. AG Br., pp. 34-36.²³ The Company makes three arguments on brief in response. First, based on some extra-record "numbers" which have not be admitted into evidence, the Company argues that the real numbers for 2001 were higher than those used in the Gallagher study. Co. In. Br., pp. 92-93. Frankly, the Attorney General has not seen any of these numbers, so there is no basis from which to analyze the Company's assertions other than to indicate that such information should not be put into the record at this late date since none of the parties in the case have had any opportunity to scrutinize the appropriateness of the Company's assertions.

²² Given the additional payout associated with those retiring employees golden parachutes, there probably won't be any saving associated with those early retirements for many years to come.

²³ The Attorney General showed on brief that for the twelve months ended June 30, 2001, Gallagher forecast costs to increase 9.8 percent over the previous twelve months. Exh. BG-7, Supplemental Schedule H, p. 1 ("Total Fixed & Projected Costs – using actual annualized claims"), while medical costs actually increased only 4.73 percent during that period. Compare Exh. BG-7, Supplemental Schedule H ("Total Fixed & Projected Costs – using actual annualized claims") page 1, Effective for July 1, 2000 Actual Annual Cost of \$1,306,551 and page 2 Actual Effective for July 1, 2001 Actual Annual Cost of \$1,368,401. Gallagher's estimates at twice the rate of the actual increases provides uncontravertable evidence as to their unreliability.

Second, the Company asserts that the Attorney General somehow misunderstood that its proposed adjustment was for a calendar year, while all of the numbers that were analyzed during the hearing and in the Attorney General's brief were done on the Company's fiscal year ended June 30, none of it applies in this case. This is simply a red-herring. The Attorney General's analysis which demonstrated Gallagher's gross over-estimates of actual inflation of medical costs simply followed the Gallagher study's own worksheets which were all done on the June 30 fiscal year. Finally, the Company makes the argument that the Attorney General made errors in his calculation of the appropriate adjustment to test year book medical expense by double-counting the adjustments for Rentals and Merchandising and Jobbing.

This last assertion is not only incorrect, but it also shows that the Company lacks a fundamental understanding of its own accounting and proposed adjustment. According to the Company's own witness, the medical expense booked to the utility operations O&M expense during the test year was \$955,600.²⁴ Regardless of the final amount medical expense that the Department finds appropriate for utility operations O&M, the adjustment must be made relative to this amount. Thus, when the Attorney General recommended a "Total Adjustment To Test Year Booked Medical Expense" of \$826, this would result in a pro forma medical expense for utilities operations of \$956,426 (\$955,600 + \$826). Accordingly, the actual pro forma expense that the Attorney General recommended in this case provides for the \$89,101 increase over the \$920,106 medical expense that the Company attributed to its utilities for the test year. However, that amount had to be reduced by the Rate Year Employee Co-

²⁴ This booked amount to utilities operation actually included amounts that should have been allocated to Rentals and Merchandising and Jobbing.

Payment amount of \$52,781. Thus, the same amount is determined as the pro forma expense to be included in the cost of service \$956,426 (\$920,106 + \$89,101 - \$52,781). Therefore, the appropriate final adjustment to test year booked expense of \$955,600 in this case is \$826 as proposed by the Attorney General.

4. THE DEPARTMENT SHOULD ALLOCATE A PORTION OF ITS 401(K) COSTS TO CONSTRUCTION AS WELL AS NON-UTILITY BUSINESSES

The Company incurred \$233,903 of costs associated with its 401(K) Plan benefit for employees and failed to allocate its 401 K Plan costs to non-utility operations and failed to capitalize any of these costs during the test year in this case. See Exh. AG-1-40 (the dollar amount and percent capitalized of employee wages, salaries and benefits during the test year) and See Exh. BG-8, Appendix I, pp. 7-10 and Exh. BG-9, Non-Utility Schedules, Supplemental Schedule NU-F. The Attorney General argued that the Department should order the Company to allocate appropriate amounts of the 401K Plan costs to those activities according to the wages and salaries allocated thereto. AG Br., p. 36 *citing Berkshire Gas Company*, D.P.U. 92-210, pp. 9, 13, 18. The Company generally agrees with the Attorney General, although Berkshire proposes to use different allocators of costs. However, the Company's proposed allocation methodology fails to allocate any costs to the Conservation Load Management ("CLM"), Energy Conservation Services ("ECS"), and clearing accounts. Exh. BG-9, supplemental schedule MUF. Since payroll is allocated to those accounts so should the 401(K) plan costs. *Id.*

5. THE DEPARTMENT SHOULD DENY THE COMPANY'S PROPOSED STRIKE CONTINGENCY COSTS AMORTIZATION PERIOD

The Company proposes to amortize \$162,436 of Strike Contingency costs that it incurred

during the test year over a three-year period, the average period it anticipates between union contract negotiations. Exh. BG-5, pp. 18-19 and Exh. BG-6, Schedule JJK-21. The Attorney General argued on brief that if the Department accepts the Company's request, it should reject the Company's proposed 3-year amortization period and instead use a 19-year amortization period that reflects the actual period between occurrences since the last time that the Company actually experience a strike from its union was more than 19 years ago in 1982. AG Br., p. 40 *citing* Tr. 14, p.1584 and Exh. DTE-RR-31. The Company argues on brief that these costs like building fences and employing security guards are necessary every time it negotiates with its union, simply prepare for a strike not for the strike itself. Co. In. Br., p. 95. The Attorney General agrees with the Company that it should always have a plan in place to protect its assets and employees in the case of a strike. However, that requirement is very different from actually incurring the incremental costs each time for fences, security personnel, overtime, etc. associated with actually having a strike as the Company added during the test year. Therefore, the Department should deny the Company's proposed adjustment in this case.

6. THE COMPANY SHOULD REIMBURSE CUSTOMERS FOR THE GIFTING OF ASSETS TO OFFICERS

The Company received no compensation for the automobile given to its former CEO Mr. Robinson and received only \$10,269 for the automobile it gave to its former VP Mr. Marrone. The Attorney General argued on brief that the Department should reduce the cost of service by \$18,140 to recognize the gift of Company assets to former employees. AG Br., pp. 41-42. The Company implies that in both cases, the vehicle give-aways were a required part of their severance packages. Co. Br. ,

pp. 96-97. Again, this unusual give-away of Company assets should not be condoned by the Department. Therefore, the Department should require the Company to return the market value of those automobiles to customers.

B. RATE CASE EXPENSE

1. LEGAL AND CONSULTING SERVICES

a. Legal Services

The Attorney General argued on brief that the Company's test year legal fees in this case should be denied since Berkshire did not issue an RFP to solicit competitive bids for legal services in connection with the rate case and did not provide a credible explanation for this failure during the hearings. AG Br., pp. 43-45 *citing Fitchburg Gas And Electric Light Company*, D.T.E. 98-51, p. 57 (1998); *Boston Gas Company*, D.P.U. 96-50, p. 79 (1996); and *Cambridge / Commonwealth Electric Company*, D.P.U. 92-250, pp. 121-131 (1992). The Department allows recovery of only known and measurable legal expenses. *Blackstone Gas Company*, D.T.E. 01-50, pp. 22-23 (2001) (citations omitted).

Although the Department had specifically warned the Company in the last rate case to be prepared to prove rate case expense in the future, D.P.U. 92-210, p. 84, Berkshire expressly decided to embark on an "innovative active approach" to managing legal costs. Co. In. Br. p. 105. This virtually paperless approach involves nothing more than alleged phone calls and the occasional letter.²⁵

²⁵ Despite the Company's claim on brief of regular telephone status reports to Mr. Allesio and Ms. Zink, there is no record evidence of such a practice. Even if such evidence were presented, the Company still has a duty to require adequate documentation from its outside experts before requesting that customers pay hundreds of thousands of dollars in expenses.

Id., pp. 105-106. A typical monthly bill for rate case expense under this “innovative approach” reads as follows: “Legal services for the period ending May 31, 2001 with respect to: 2001 rate case [is] \$34,056.00.” AG-RR-39. Nothing further describes the work supposedly done besides a listing of the name of the attorneys working on the case on a monthly basis. The Company’s claims of oral “briefings” on legal services finds no record support. Co. In. Br., p. 108. By implementing this paperless and nearly unreviewable approach to legal billing, the legal expenses are not properly controlled or quantified under Department precedent. *Blackstone Gas Company*, D.T.E. 01-50, pp. 22-23 (“A known and measurable expense is a quantified expense that has been incurred by the company.”)

Curiously, Berkshire applied this “innovative approach” only to Rich May while all the other law firms submitting invoices to the Company included a reasonably detailed description of the legal services rendered. Compare, for example, an invoice entry for just one day of legal services from Brown Rudnick for D.T.E. 01-41 : “05/15/01 Wadsworth – Conference with K. Zink and J. Avery; prepare for DTE hearing; conference call to B. Cronin re: confidentiality issues, direct testimony – 4.1 (hours) – \$1,558.00 (value)”. AG-RR– 39. Berkshire did not adequately explain the reasons for the failure to issue an RFP and, instead adopted a somewhat secretive approach to legal billing that rendered the invoices inadequately known or measurable.²⁶ As a result, the Department should reject the claim for recovery of legal expenses.

b. Consultant Services

²⁶ The Company’s Initial brief contains no explanation for what has become of the missing pages from the Rich May bills. See AG Br., p. 44 n 29.

The Attorney General argued that the Department should reject the inclusion of rate case expense beyond the original estimates, since the Company could not offer a convincing explanation for why the MAC consulting fees greatly increased or what efforts the Company undertook to control these costs and why there were overlapping areas of testimony for Berkshire's numerous witnesses and the hiring of two experts for testimony from MAC when the Company historically relied on only one for previous rate cases. AG Br., pp.43-46. The Company's Initial Brief merely highlights that the Company's own planning failures, stonewalling and disproportionately complex rate case caused an inflation to the rate case expense. Co. In. Br., p. 109.

c. Mr. Kelley's Consultant Fees

The Company's whole position argued on brief is based on the one statement made by Mr. Kruszyna that Mr. Kelley "regularly" met with Mr. Allesio to discuss "utility operations." However, when asked to provide one scintilla of proof of any of these meetings or any work done by Mr. Kelley for the Company, Mr. Kruszyna could provide nothing: no notes, no memoranda, no studies, no work product of any kind. The Department must have a higher standard than bald unsupported statements like Mr. Kruszyna's when seeking proof of the reasonableness of the costs used to set rates. Therefore, the Department should deny the Company's request for any of Mr. Kelley's "consulting fees."

C. UNRECOVERED ENVIRONMENTAL COSTS ARE UNRECOVERABLE

The Company has included in the test year cost of service approximately \$104,000 of "unrecovered" environmental (remediation) costs. Exh. AG-2-4, p. 12-1, line 9. The Attorney General argued on brief that the Department should disallow recovery of the unrecovered

environmental costs and put the Company on notice that it must provide, at a minimum, explicit testimony and supporting materials whenever seeking to change the traditional treatment afforded a specific type of cost, since as the Department has ruled, remediation costs may not be recovered through base rates unless a company specifically petitioned for such treatment in lieu of recovery as specified in the settlement agreement and then only under certain conditions. D.P.U. 89-161, pp. 35-37. and D.P.U. 90-151/152/182/198, p. 57.

The Company claims in its Initial Brief that the “unrecovered” environmental costs are related to already contaminated property the Company purchased.²⁷ Co. In. Br., p. 100. The record in this case is completely devoid of any details regarding this transaction.²⁸ If Company can not deduct the costs for tax purposes, neither the cost nor the tax liability should be passed on to customers. The Department must require the Company to remove this cost from its test year cost of service and disallow recovery of non-deductible remediation costs through any customer charge component (base rates, CGA or LDAC) until such time as the Company has fully supported the prudence of the related investment and Department has made a determination regarding the extent customers should bear any

²⁷ The Company asserts that it was given tax advice regarding the non-deductibility of remediation costs related to contamination by previous owners by a tax attorney, but the Company has no written documentation supporting the specific advice given. In response to a record request the Company provided documents related to IRS letter rulings, technical advice memoranda and revenue rulings, none of which address Berkshire specifically. AG-RR-30. On brief the Company simply refers to the record response and the “vagaries of the Internal Revenue Code” as the basis for the Company’s being denied deferred tax benefits related to the costs in question. Co. In. Br., p. 100.

²⁸ The record regarding this issue is unclear. Berkshire has provided such scant proof that the amount in question may be the tax liability associated with the cost being amortized or it may be that portion of the remediation costs that has been deemed non-deductible. It appears that it may be the latter since the cost is booked to account 814, Other Gas Supply Expenses-Environmental and not a tax account. Exh. BG-18, p. 50.

related remediation costs.

D. SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN

The Company proposes to include in its pro forma cost of service the accelerated costs of the severance packages associated with the early retirement of its executive officers who both left the Company as a result of the acquisition by Energy East. Exh. BG-6, Schedule 28. The Attorney General argues on brief that the Department should deny these costs since, but for the acquisition, the Company would not have been required to make these accelerated payments. *Id.* The Company implies that the Attorney General is confused and argues that the “normalized” payment included in the cost of service would have been incurred by the Company on a standalone basis, and therefore it should be included in the revenue requirement in this case.²⁹ There is no confusion on the Attorney General’s part. The SERPs are so-called “golden parachutes” that were signed in 1998 in anticipation of an acquisition of BER. They had nothing to do with utility operations and the provision of service to customers. Therefore, these costs should not now, nor in the future, be included in the cost of service used to determine rates.

VIII. RATE STRUCTURE

A. THE MBA ALLOCATOR

The Company supports its proposed use of MBA allocation methodology by arguing that the

²⁹ The Company here and in many other sections throughout its brief scolds the Attorney General as being “confused” about the Company’s position. *See* Co. Br., pp. 95, 96, 98, and 106. To the contrary, in all of these instances, the Attorney General fully understands and appreciates what the Company is trying to do.

MBA methodology has been: 1) reviewed by the Department in four other cases; 2) used by three other Massachusetts gas distribution companies; and, 3) represents a substantial improvement over the current CGA gas cost allocation method. Co. In. Br., pp. 178-179. The first two claims are nothing but red herrings. The Department has never specifically accepted the MBA allocation methodology. Of the three companies employing the MBA only one is doing so as the result of an adjudicated proceeding, Fitchburg Gas and Electric Light Company. In the Fitchburg case the Department did not accept the MBA allocation methodology. It only stated a preference for load factor based CGAs. *Fitchburg Gas and Electric Light Company*, D.T.E. 98-51, p. 153 (1998). The third claim has been clearly and repeatedly refuted by the Attorney General's expert witness, Mr. Chernick. Mr. Chernick testified that the term "Market Based Allocator" is a misnomer since the MBA does not reflect competitive market pricing. Exh. AG-7, pp. 13-14 and Tr. 17, p. 1951. He also testified that it is not an improvement over the Company's current methodology where there is effectively a load factor seasonal differentiation (i.e, low load factor customers pay higher gas costs over the year than high load factor customers simply due to the fact that low load factor customers use more gas in the winter when the CGA price includes most capacity costs).³⁰ *Id.* In addition, the MBA introduces a level of complexity that renders the development of the allocators un-reviewable within the context of the CGA

³⁰ Mr. Chernick also testified that there are many ways of creating specific class or load factor allocations that do not involve the subjective and discretionary, almost mystical machinations inherent to the development of these MBA allocators. Exh. AG-7, pp. 13-14, 24 and Tr. 17, p. 1959. Mr. Chernick recommended that the Department assess the propriety of various methodologies within the context of a view of how to best transition to a competitive natural gas marketplace. This assessment would be done in a generic proceeding involving all companies and interested parties and would result in a set of standards for allocating gas costs. *Id.* pp. 24-25 and Tr. 17, pp. 1961-1962.

filing and implementation time frame³¹, and provides the Company with the discretion to manipulate the price high load factor customers in order to retain or attract them as sales customers³² (even if they are uneconomic to serve) under the guise of preventing “cherry picking.” *Id.* at 14, 18-19 and Tr. 17, p. 1918.

The Company criticizes Mr. Chernick’s standards for the development of an appropriate allocator as being unrealistic. Co. In. Br., pp. 182-183. In addition, the Company criticizes Mr. Chernick’s recalculations of a Company proposed hypothetical in an attempt to show the MBA is superior to a Proportional Responsibility- type allocation. Co. In. Br., pp. 183-184. These darts fall short of the mark. Mr. Chernick did not advocate the use of any specific allocator. After review he has found the Company’s proposal to be fatally flawed and recommended that the Department reject the proposal and conduct an investigation into the most appropriate methodology for use during the transition to a competitive market in Massachusetts. The Department can use this opportunity to commence a state-wide revamping of the CGA and defer approval of a load factor based CGA for Berkshire until resolution of the investigation.

³¹ The Company is impressed that Mr. Chernick is able to understand the MBA calculations and uses this understanding to bolster its claim that the calculations are not too complex to be reviewable within the context of the CGA approval process. Co. In. Br., p. 181. After spending a substantial amount of time reviewing the Company’s calculations, Mr. Chernick determined that the MBA approach is not well defined and requires detailed analysis to determine what assumptions and judgements have been employed each time the allocators are calculated. Exh. AG-7, pp. 6-8, 10-12 and Exh. BG-1-21. Mr. Chernick found that the Company’s supporting documentation to be incomplete and the explanations provided were often incorrect or misleading. *Id.* Given the very short timetable in a CGA approval process, this type of detailed analysis could not be conducted.

³² Mr. Chernick has detailed the key decision points where the Company’s judgement has led to inappropriate cost allocation. These include the assumptions underlying the base load, the treatment of interruptible sales, off system sales and capacity release and the pricing of storage gas. Exh. AG-7 pp. 4, 15-17, 20.

B. FARM DISCOUNT

In its brief Berkshire rehashes its proposal regarding the recovery of farm discount costs. Co. In. Br., p. 75. The Company seeks to recover the accumulated cost of farm discounts incurred since the 1998 implementation date of the program and through 2001 (beyond the test year). The proposal is to amortize the estimated accumulated discounts of \$69,234 over a four-year period³³. The Company has included the resulting annual amortization amount of \$17,309 in its test year cost of service.

Berkshire mistakenly believes that it is entitled to this amortization. Although the Company relies on the Department's order in the unbundling docket as supporting its belief, in the citation provided the Department addresses the Farm Discount as a mandatory provision of generic terms and conditions applicable to all LDCs. *Rulemaking, pursuant to G.L. c. 164, and c. 25, to establish rules governing the unbundling of services related to the provision of natural gas*, D.T.E. 98-32-E, Attachment A, § 13.03 (3) (1999). This order does not address the deferral of farm discount costs³⁴.

The farm discounts, like low income discounts, are recoverable through rates to the extent they are known and measurable. There is no need for deferral and amortization. *Boston Gas Company*,

³³ The four-year amortization period is based on an average period between rate cases. Exh. BG-25, p. 6. A more appropriate amortization period would be 10 years in this case—the anticipated duration of the Company's proposed PCM Plan.

³⁴ It should be noted that in a separate proceeding the Department did allow gas distribution companies the opportunity to “defer costs associated with the implementation of the Farm Discount for consideration in a subsequent general rate case.” *Farm Discounts*, D.T.E. 98-47, pp. 5-6 (1998) (denying Berkshire's request for recovery of farm discount costs through the LDAC). The Department's ruling did not give companies blanket authority to defer costs, it did not authorize the recovery of deferred costs through rates set in any subsequent rate case, nor it did narrowly address the discount itself as being a cost that may be deferred—rather the Department, consistent with its North Attleboro deferral standard, looked to a broader level of costs, the costs of implementation which for some companies could have been of such significance that they would qualify for deferral.

D.P.U. 93-60, p. 385 (1993). In order to defer an expense, according to the Department's standard, a company must petition the Department and

[A] company must demonstrate prima facie in its petition that: (1) based on Department precedent, the annual expense may be recoverable as an extraordinary expense if it were incurred during a test year; (2) a Department denial of the request for deferral would significantly harm the overall financial condition of the company; and (3) the Department's denial of the request for deferral is likely to cause the filing of a rate case that would include in its test year the expense for which deferral is sought.

North Attleboro Gas Company, D.P.U. 93-229, p. 7 (1994). Apparently the Company failed to petition the Department for approval of deferral treatment as required by the Department's standard for the obvious reasons that none of the required conditions apply to the pre and post test year farm discount costs the Company seeks to amortize. The Company's farm discount costs are not extraordinary costs as defined above, nor are they of such a significant amount that they would cause financial harm without rate relief. The Department must order the Company to remove this amortization amount and any associated carrying costs from the test year cost of service. The Company is entitled to recovery based on the test year level of the farm discount which, according to Ms. Boucher's testimony, has been reflected in the Company's revenue deficiency calculation. Exh. BG-25, p. 6.

C. INAPPROPRIATE ADJUSTMENTS

The Company proposed two adjustments in the rate design section of its filing—an increase in the number of Low Income customers and an increase in the revenue deficiency due to the removal of the test year LBRs. Exh. BG-22, p. 36, Exh. BG-15, p. 28, Exh. BG-17, Sched. PMN-6, Exh. DOER-1-19 (LBR increase in revenue requirement does not appear in Mr. Kruszyna's cost of service).

IX. COST OF CAPITAL

A. INTRODUCTION

The Company argues at length on brief about the new and higher risks that it faces as a result of being in business. Co. Br., pp. 122-131. This over exuberance to inflate the investment risks and expected return requirements can all be dismissed with the recognition that the Company is still a monopoly provider of natural gas distribution services, a necessary service for the residences and business in its geographic area. To the contrary, the Department should recognize that the Company's investment risk has decreased now that it is part of the much larger Energy East holding company.

The Department should also recognize the change in cost of money since the Company's last base rate case, D.P.U. 92-210. In the that case, the Department found that the Company's cost of equity was 11.5 percent. *Id.*, p. 156. Since that time, interest rates have dropped precipitously. For instance, the yield on 30-year U.S. Treasury bonds has decreased 250 basis points. Tr. 5, p. 606. Similarly, the yield on "A" rate utility bonds decreased by 125 basis points. Tr. 5, pp. 605-606. Therefore, risk premium analyses using long-term debt would require a comparable decrease in the cost of equity for the Company, reducing the allowed return on common equity to between 9.00 (11.5 - 2.5) and 10.25 (11.5 - 1.25) percent. The Attorney General's recommendation from his Initial Brief of 9.84 percent falls within this range of reasonable returns and therefore, the Department order the Company to use a 9.84 percent return on common equity to determine its rates.

B. THE DCF GROWTH RATE

The growth rate used in the DCF model is the investors' mean expected long run growth rate in dividends paid per share. Exh. BG-11, Appendix E, p. E-9 ("viewed in its infinite form, the DCF

model is represented by the discounted value of an endless stream of growing dividends.”). The Attorney General argued on brief that the Department should reject Mr. Moul’s recommendation since (1) it ignores investors’ expectations regarding their growth rate estimates including historical and forecasted measures of dividends, earnings, and book value per share growth rates as well as the growth rates from retained earnings resulting in a growth rate estimate that is 375 basis points above the historical dividend growth rate and 422 basis points above the projected dividend growth rate; (2) it is based on short-term earnings projections that have not stood the test of time and (3) it is 1.50 percent higher than the 5.5 percent long-run consensus growth rate forecast of the overall economy. Exh. AG-RR-7, p. 14, (“Nominal G.P. Consensus” is 5.5% for 2003-2007 and 5.4% for 2008-2012) .

The Company argues on brief that the Department should ignore historical growth rates when performing the DCF analysis since they are “contaminated” by negative growth rates. Co. Br., p. 146. It goes without saying that this “cleansing” of statistical data is not only inappropriate with no underlying theoretical support, but it also is simply used as another one of Mr. Moul’s goes to bias his cost of equity estimates upward. See AG Br., pp. 80-82.³⁵

The Company’s attorneys also “testify” at length on brief regarding any attempt to measure the long-run growth rate expectations that should be used for a utility company, simply relying on short-term forecasts instead. Co. In. Br., pp. 147-148. First, without any record cites, this lawyer testimony should be stricken from the Company’s Brief and ignored by the Department in its decision. Second,

³⁵ While Mr. Moul goes out of his way to cleanse the historical data of those growth rates he finds are too low, he never seems to find the time to cleanse that data of the growth rates that are too high. This obviously results in “contaminated” results and recommendations.

as was shown in the Attorney General's Brief all reasonable estimates of the DCF growth rate that are supposed to represent the growth in the company and its dividends out to infinity are in line with the consensus long run growth in the economy. AG Br., pp. 72-73. This includes the historical growth rate of four percent for dividends for comparable utilities since Berkshire's last rate case, and the short-term historical growth rates in combination with short-term forecast growth rates. *Id.* Given all of these other proxies for the DCF growth rate which indicate a substantially lower prospect for growth rate for the comparison group, Mr. Moul's myopic view and 100% reliance on short-term earnings forecasts is unsupported by the record. Finally, given that the sources of the data used for Mr. Moul's forecasts include stock brokers and investment houses whose interest it is to peddle the very products which they are "analyzing," it is no wonder that such forecasts overstate the prospects of companies in the comparison group. Tr. 5, pp. 591.³⁶

C. MR. MOUL'S RISK ANALYSIS AND RISK ADJUSTMENTS SHOULD BE REJECTED BY THE DEPARTMENT

Mr. Moul labors hard in this case to find reasons to increase his cost of equity recommendations by creating brand new adjustments to the results of analyses based on specific cost or risk factors that he now deems worthy of measuring. The Attorney General argued that while these adjustments increase the cost of equity for his comparison group, and ultimately for the Company, Mr. Moul ignores what is probable the most important single factor that investors consider when investing in

³⁶ Of course, it is this infamous over exuberance on the part of these institutions that caused not only the "dot.com" bubble to burst, but also the many Securities and Exchange Commission investigations into those firms that publish equity analysis of companies while at the same time underwriting their securities.

the comparison group -- the non-utility businesses that the companies are involved in increase the risk for these companies.

The Company argues against the Attorney General's position that Mr. Moul's cost of equity results need to be adjusted to remove the effects of the comparison group's non-regulated, since he did not quantify the change in cost of capital. Co. Br., pp. 160-161. A simple calculation of the effects on the overall cost of equity can be demonstrated. If for instance the 69 percent of cost of equity for the regulated gas distribution company is 10 percent and the other 31 percent of cost of equity for the unregulated subsidiaries is 20 percent, the overall cost of equity for the stock would be determined as follows:

	Percent Common Equity	Cost Of Common Equity	Weighted Cost
Regulated Utility	69%	10%	6.9%
Unregulated Business	31	20	6.2
Overall Cost Of Equity			13.1%

This example shows that even with relatively small equity positions, the overall cost of equity for the stock can be dramatically effected by the non-regulated businesses in oil and gas exploration and energy marketing for the comparison group of companies.

D. CONCLUSION

For all of the reasons stated here and in the Attorney General's Brief, the Department should rejected Mr. Moul's cost of equity analysis and instead set the Company's allowed return on common equity at 9.84 percent. This level of return is within the reasonable range returns for the Company and will provide the Company sufficient compensation to meet the standards of *Bluefield Water Works and Improvement Company v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923) and *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591 (1942).

X. DEPRECIATION EXPENSE

A. ACCOUNT 305 – MANUFACTURED GAS PRODUCTION PLANT STRUCTURES AND IMPROVEMENTS

Mr. Aikman recommends using a 34 year life for the new Whately LNG Facility - Account 305, Structures and Improvements and using a 24 year life for Account 319.10 – Gas Mixing Equipment associated with the Whately LNG Facility. *Id.* . *Id.* p. 6 and Tr. 10, pp. 1099-1108.

The Attorney General argued that Mr. Aikman's analysis mixes and matches service life estimates to artificially and inappropriately reduce the average service life of the Whately LNG by identifying only those certain units of property that have shorter lives to reduce the overall average for the new facility.³⁷

³⁷ Certainly, one could find units of property at these sites that have useful lives greater than 40 years. Failure to specifically identify these and include them in the calculation bias Mr. Aikman's

The Company argues that the Attorney General cited no “authority” for the proposition that a utility should use its own historical experience regarding the average service life of plant accounts. This argument shows the Company’s misunderstanding of the whole basis of Mr. Aikman’s and the Department’s purpose of doing average service life studies. The Company is essentially arguing that life analyses and the particular utility’s own experience are meaningless in determining the depreciation accrual rates. The Company believes that it is preferable for the Department to simply assume some back of the envelope number that may have no relation to the Company’s own circumstances or experience even though it has a complete actuarial history of that plant. The question to the Company then is: why have Mr. Aikman and why do actuarial studies ?

It has been the Department’s longstanding policy to use actuarial studies to determine the depreciation accrual rates and the depreciation expense that utilities are allowed to include in the cost of service used to determine rates. See for instance *Fitchburg Gas & Electric Light Company*, D.P.U. 98-51, pp. 77-78 (1998); *Boston Gas Company*, D.P.U. 96-50 (Phase I), pp. 104 (1996); and *Berkshire Gas Company*, D.P.U. 92-210, pp. 69-72 (1993). The Company has not offered any reason for the Department to deviate from this well-founded policy.

More important, the Department has held that where a witness reaches a conclusion about a depreciation study that is at variance with the engineering and statistical analysis, the Department will not accept such a conclusion without sufficient record support for such a departure. *Fitchburg Gas & Electric Light Company*, D.P.U. 98-51, pp. 77-78 (1998); *Boston Gas Company*, D.P.U. 93-60,

analyses towards shorter lives.

pp. 182-183 (1993); *Bay State Gas Company*, D.P.U. 92-111, p. 121 (1993); *Commonwealth Electric Company*, D.P.U. 89-114 / 90-331 / 91-80 (Phase I), pp. 54-55 (1991). Although the Department acknowledges that the determination of an appropriate average service life and accrual rate requires reliance on informed judgement, the exercise of this judgment must be supported on the record before it is accepted by the Department. *Fitchburg Gas & Electric Light Company*, D.P.U. 98-51, pp. 77-78, n. 46 (1998) citing *Berkshire Gas Company*, D.P.U. 19580, p. 19 (1978). In the case of Mr. Aikman's analyses and recommendations of Account 305 and Account 319.10 plant, Mr. Aikman provided absolutely no analysis nor any reason for the Department to deviate from the actuarial analysis. Simply providing a calculation of his preferred lives of the units of property without any discussion of why those units are different from those existing in the account does not provide evidence or reason for a deviation from the Company's own actuarial analysis for that account.

Furthermore, the Department should note the glaring inconsistency in the Company's arguments and Mr. Aikman's recommendation with regard to deviating from actuarial analysis. When the Attorney General recommends that studies be performed on the various types of mains and services due to the problems with the coating on certain pipes and the cast iron pipes which the Company and the Department have recognized that have both caused dramatic and artificial decreases in the average service lives of the mains and service accounts Mr. Aikman and the Company balk, or deny that they exist. Co. In. Br., p. 121. The result is that the actuarial life analyses are being driven by these short-term problems with relatively small balances of plant, even though substantially all of the dollars added to those account balances since the 1970s are plastic and coated steel pipe. There the deviation from the historical lives is real and significant causing a major inflation of the depreciation accrual rate. Yet,

Mr. Aikman finds no reason to recognize those problems with the mains and services, obviously since they cut in favor of customers. Conversely, he disaggregates, by units of property, the plant in the cases of Account 305 and 319.10 without any reason, since using his back of the envelope calculations will provide faster recovery for shareholders. The Department has consistently denied these unsupported attempts to deviate from the actuarial results of the plant account. *Fitchburg Gas & Electric Light Company*, D.P.U. 98-51, pp. 77-78, n. 46 (1998) citing *Berkshire Gas Company*, D.P.U. 19580, p. 19 (1978).

For all of the reasons stated here and in the Attorney General's brief the Department should order the Company to use the results of the actuarial analyses in Accounts 305 and 319.10 to determine the lives of the plant, rather than Mr. Aikman's unsupported back of the envelope calculations.

B. MAINS AND SERVICES

The Company's argues on brief that: (1) the services have been included in rates for years, are therefore used and useful, and no change in depreciation is necessary (citing *Berkshire Gas Company*, 92-210, p. 22); (2) there is no basis for a finding of imprudence; and (3) a proxy for the average service life "flies squarely in the fact of logic." All of these arguments are wrong.

First, the Company's argument citing Department precedent regarding the used and useful plant is inappropriate since that relates simply to putting plant in rate base. The Department continually changes plant depreciation over its service life in order to allow for adjustments in the assumptions used

to determine the accrual.³⁸ Second, the argument that no imprudence was proven on the record is contradicted by the Company's own witness who stated that absolutely nothing was done to recover of the costs of these obviously defective products after the defect was found. Finally, the use of proxies to determine costs in the absence of data is a standard technique that the Department has employed when determining depreciation accrual rates as well as many other costs including capital structure ratios (see for instance *Blackstone Gas Company*, D.T.E. 01-50, p. 24 (2001), *Assabet Water Company*, D.P.U. 95-92, p. 33 (1996); and *Wylde Wood Water Works*, D.P.U. 86-93, p. 25 (1987)), and costs of equity (see for instance Exh. BG-10 [Mr. Moul's use of a proxy group] *Blackstone Gas Company*, D.T.E. 01-50, p. 25 (2001); *Fitchburg Gas & Electric Light Company*, D.T.E. 99-118, pp. 78-81 (2001)). The Department should use one here that is much higher than Mr. Aikman's recommendation since it is clear that the Company's actuarial lives for mains and services do not reflect those expected in the future for the bulk of those accounts.

XI. HEDGING

Low Income Energy Affordability Network ("LEAN") in its "opening" brief addresses the issue of gas price volatility and its effect on low income customers. LEAN calls for the implementation of hedging techniques to mitigate the potential for future gas cost spikes that may be reflected in the Company's spot purchases. These costs are passed directly through to customers via the CGA. LEAN Br. pp. 1-2. The Attorney General agrees that spot gas prices can be volatile. However, customers are able to enter into levelized billing and payment options with the Company thus mitigate

³⁸ Using the Company's reasoning, the Department could never change the depreciation accrual rate for plant once it has been put in rate base.

the impact of extreme price volatility. To allow Berkshire to enter into the world of complex both physical and financial gas transactions (where participants have expertise and resources significantly more sophisticated than Berkshire's) puts customers in a position of much higher risk than that posed by spot gas prices.³⁹

Massachusetts is in the midst of a transition to a competitive market. Until the Department makes a formal determination that the transition is over or that alternative strategies and programs should be implemented to foster increased competition, the Commonwealth's gas utilities are moving toward exiting the market function and have been encouraged by the Department not to enter into long term supply contracts. *Investigation by the Department of Telecommunications and Energy upon its own motion commencing a Notice of Inquiry pursuant to 220 C.M.R. § 2.00 et seq. into the unbundling of all natural gas local distribution companies' services*, D.T.E. 98-32-B (1999). The Department has found that fixed prices are not in the best interests for the customers:

While customers would be protected from increased prices, they would also be foreclosed from receiving any benefits from reduced prices. At this juncture, an indexed or floating pricing mechanism is preferable.

Id. The Department must revise its policy before the gas acquisition strategies LEAN advocates can be implemented. The Attorney General would not necessarily object to the Company providing gas service through a subsidiary on a fully competitive basis. Customers would be free to choose to participate in hedged services and the utility gas customers would not be responsible for hedging strategies that result in prices higher than spot or the bear the additional costs of implementing a hedging

³⁹ This is a world where recently arguably the largest and most sophisticated market participant apparently has suffered irreparable financial damage.

program. The record in this case is totally devoid of any support for policy changes of the magnitude and as far-reaching as those advocated by LEAN, and therefore the Department should not authorize any hedging activities in its decision here.

XII. CONCLUSION

WHEREFORE, for all of the foregoing reasons, the Attorney General urges the Department to issue an order consistent with his recommendations contained herein.

Respectfully submitted,

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